**DEPARTMENT OF STATE REVENUE**

**LETTER OF FINDINGS NUMBER 97-0318 ST**
**SALES AND USE TAX**

**For Tax Periods: 1993 Through 1995**

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning specific issues.

## ISSUES

### 1. Sales and Use Tax- Lease Transactions

**Authority:** IC 6-2.5-2-1 (a), IC 6-2.5-4-10(a), IC 6-2.5-4-4.

Taxpayer protests the assessment of tax on certain lease transactions.

### 2. Sales and Use Tax- Printed Publications

**Authority:** IC 6-2.5-1-1, IC 6-2,5-1-2(b), Cowden & Sons Trucking, Inc. v. Indiana Department of Revenue, 575 N.E.2d 718 (Ind. Tax Court 1991), IC 6-2.5-5-36.

Taxpayer protests the assessment of tax based on the costs of the printed publications minus reprints.

### 3. Sales and Use Tax-Voice/Fax System

**Authority:** Information Bulletin #8

Taxpayer protests the assessment of tax on a purchase of a voice/fax system.

## STATEMENT OF FACTS

Taxpayer is an Indiana corporation that distributes magazines that it produces pursuant to a franchise agreement. Taxpayer receives its income from sales of advertising in the magazine rather than sales to consumers. The Department assessed additional sales/use tax, interest and penalties after an audit. Taxpayer timely protested the assessment. Further facts will be provided as necessary.

## .1. SALES AND USE TAX: LEASE TRANSACTIONS

## DISCUSSION

Pursuant to leases, Taxpayer distributes its publications at various retail outlets and other public places that give ready access to the general public. Taxpayer places its magazines on racks in outlets such as grocery stores. Persons in the general population pick up the magazines free of charge. In some places, Taxpayer uses its own display racks. In other locations, the retail outlets allow Taxpayer to use display racks owned by the retailer. The audit assessed tax on these charges as the leasing of tangible personal property, the display racks for a fee.

IC 6-2.5-2-1 (a) imposes the state gross retail tax on "retail transactions made in Indiana." The leasing of tangible personal property is defined as a retail transaction subject to the gross retail tax in IC 6-2.5-4-10 (a). In this case, however, the display racks are not the true subjects of the leases. Evidence of this is the fact that Taxpayer supplies its own racks in certain locations. At more than one thousand dollars ($1,000.00) per month, the lease payments are significantly higher than would be reasonable based on the value of the display racks alone. The true subject of the leases is the space in the retail outlets.

IC 6-2.5-4-4 imposes gross retail tax on the provision of space when

> those rooms, lodgings, or accommodations are rented or furnished for periods of less than thirty (30) days; and the rooms, lodgings, and accommodations are located in a hotel, motel, inn, tourist camp, tourist cabin, gymnasium, hall, coliseum, or other place, where rooms, lodgings, or accommodations are regularly furnished for consideration.

The leases under consideration here are for annual periods that clearly exceed thirty (30) days. Further they are not rooms in any of the listed facilities. The leasing of space in these circumstances does not fit the statutory prerequisites for imposition of the sales and use tax.

## FINDING

Taxpayer's first point of protest is sustained.

## 2. SALES AND USE TAX: PRINTED PUBLICATIONS

Taxpayer's second point of protest concerns the assessment of gross retail tax on the printed publications. The Auditor assessed tax on the costs of Taxpayer's printed publications minus the cost of reprints that were taken from year-end balances of the general ledger accounts. The gross costs the Auditor used as the basis for taxation were the contract costs pursuant to the Franchise Agreement. Payments under this contract cover tangible personal property, services and royalty fees. The fact that Taxpayer and Franchisor do not bargain separately for the various items in the price and the single contract price indicate that the transaction is a unitary contract. Pursuant to IC 6-2.5-1-1 and 6-2.5-1-2(b) tax may be imposed on the total value of a unitary transaction. Taxpayer argues that pursuant to Cowden & Sons Trucking, Inc. v. Indiana Department of State Revenue, 575 N.E.2d 718 (Ind. Tax Court 1991), tax may be imposed on services rendered in retail unitary transactions only if the transfer of property and rendition

of services is inextricable and indivisible. In Cowden, Taxpayer purchased stone and passed the cost on to their customer. In that case there was a clearly extricable and easily ascertained price for the transfer of the tangible personal property (the stone) and the provision of services (the delivery of the stone). The transfer of the tangible personal property was also incidental to the delivery of the stone. There was every indication in Cowden that the customers clearly bargained for delivery and the sale of the stone separately. The prices reflected the transaction clearly. Although Cowden had a unitary transaction with its customers, the cost of the delivery services were divisible and extricable from the total cost of the transaction. Therefore only the cost of the stone rather than the cost of the entire contract was subject to gross retail tax. This is distinguishable from Taxpayer's situation. In this case, Franchisor has lumped together charges for the royalty payments, delivery charges, printing services and tangible personal property together as one price. The resulting invoices reflect the entire bundle of royalties, services and property the printer and Franchisor provide to Franchisee. There is no easily ascertainable way to determine the cost of the tangible personal property, the services and the royalties. The costs of transfer of property and services are not separately stated on invoices or available from the printers' books and records. The royalty fees are discussed separately in the contract but are not separately invoiced. In fact Taxpayer and similar entities have resorted to litigation in an attempt to require Franchisor to "unbundle" the costs. Clearly this contract did not include bargaining for the tangible personal property separately from the services and royalty fees. The service and royalty fees are not extricable and divisible as required by Cowden to exempt them from gross retail tax.

Also the cost of the tangible personal property used in these transactions is not incidental to the true object of the contract as in Cowden. In Cowden, the hauler delivered stone. Most customers purchased the stone directly from the producer and Cowden merely delivered it, providing nontaxable delivery services. In some situations, Cowden's customers did not have an ongoing relationship with the quarry and Cowden purchased the stone at the quarry on behalf of the customers. Customers then reimbursed Cowden for the cost of the stone. The purchase of the stone itself was incidental to the true object of the contract with Cowden. That object was the delivery of stone. In Taxpayer's case, the true object of the transaction was the transfer of completed magazines. Therefore the costs are subject to tax.

Alternatively, Taxpayer contends that it is entitled to exemption on the publications pursuant to IC 6-2.5-5-36 that provides a special rule for the sales and use taxation of commercial printing contracts. Under this statute, a Taxpayer who acquires property for use at a commercial printer's premises that the commercial printer could have provided exempt, may also acquire the property exempt. Taxpayer provides layout materials to the printer. Those are used before the production process and therefore do not qualify for exemption in Indiana. Further, this statute provides that tangible personal property Taxpayer purchased from a Florida commercial printer in Florida would not be subject to gross retail tax if the Florida commercial printer could have purchased it exempt from tax. Taxpayer has the burden of proving that the Florida commercial printer could have purchased the items tax exempt in Florida. Taxpayer did not sustain that burden of proof.

## FINDING

Taxpayer's second point of protest is denied.

## 3. SALES AND USE TAX: VOICE/FAX SYSTEM

### DISCUSSION

In 1994 Taxpayer purchased a voice/fax system. Taxpayer contends that the software portion of the contract should be exempt from tax because it is a customized system. Taxpayer relies on Information Bulletin No. 8 to support its contention. That bulletin interprets the law such that canned software is subject to gross retail tax and custom designed software is not subject to gross retail tax. In this case the contract indicates that each of the systems installed was a canned program. The fact that they were installed together and the installer had to customize them to work together does not change the basic character of the programs. As canned programs, the software is subject to gross retail tax.

### FINDING

Taxpayer's final point of protest is denied.

KA/BK/MR--990904